

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 04-29**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether the Taxpayer will be exempt from Tennessee franchise, excise taxes pursuant to the provisions of Tenn. Code Ann. § 67-4-2008(a)(8).

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the Taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual Taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The Taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The Taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

Upon completion of its formation, the Taxpayer will be a [STATE-NOT TENNESSEE] limited liability company that will perform [SERVICES] in the State of Tennessee. A copy of the Taxpayer's proposed Articles of Organization was attached to the request for this Letter Ruling.

The Taxpayer will have two members. [MEMBER ONE] a [STATE-NOT TENNESSEE] limited liability company that will own an 80% membership interest. Although [MEMBER ONE] will be the Taxpayer's managing member, it will handle all managerial acts from [STATE-NOT TENNESSEE] and, if it becomes necessary, it will delegate managerial responsibilities to one or more of the Taxpayer's on-site managers. The Taxpayer's attorney states that [MEMBER ONE] will not be subject to Tennessee franchise, excise tax because it will not be doing any business in Tennessee.

The other member will be [MEMBER TWO], a nonprofit Tennessee corporation that will own a 20% interest in the Taxpayer. [MEMBER TWO] is exempt from federal income tax pursuant to IRC § 501(c)(3). The [COMPANY A] and the [COMPANY B] are the two corporate nonprofit [. . .] owners of [MEMBER ONE] and both such owners are exempt from federal income taxes pursuant to IRC § 501(c)(3).

All income earned by the Taxpayer and allocated to [MEMBER ONE] will be allocated to its two nonprofit owners, [COMPANY A and COMPANY B]. The Taxpayer's attorney states that [COMPANY A and COMPANY B] will each be subject to Tennessee franchise tax on the greater of Tennessee net worth or real or tangible personal property, and excise tax on Tennessee net earnings attributable to activities that are unrelated to and outside the scope of the activities that gave them their not-for-profit status.

The Taxpayer's Articles of Organization will contain a provision that its members, [MEMBER ONE] and [MEMBER TWO], will each be personally liable for all debts, obligations and liabilities of the Taxpayer to the same extent as a general partner in a general partnership¹. Upon receipt of a favorable Letter Ruling from the Tennessee Department of Revenue to the effect that the Taxpayer will be exempt from Tennessee

¹ The statement contained in the Taxpayer's proposed Articles of Organization reads as follows: "The undersigned members, constituting the only current members of this limited liability company, have each agreed and each does hereby agree that such member, as a member, will be personally liable for all of the debts, obligations and liabilities of the limited liability company, and each such specifically identified member shall be liable to the same extent as a general partner in a general partnership. The preceding sentence is intended to allow the limited liability company to comply with Section 67-4-2008(a)(9) [sic.] of the Tennessee Code such that the limited liability company shall be exempt from the Tennessee excise tax for its Tennessee operations and shall be interpreted consistently therewith." (Note that the Tenn. Code Ann. § cited should be 67-4-2008(a)(8) and it should be stated that the exemption will also apply to the Tennessee franchise tax.)

The Taxpayer's proposed Articles of Organization also contain a provision that protects any person who has served or is currently serving as manager of the limited liability company from personal liability in any monetary damage action for breach of duty as a manager. However, this provision does not negate the fact that the members of the limited liability company, will each agree to be personally liable for all of the debts, obligations and liabilities of the limited liability company to the same extent as a general partner in a general partnership.

franchise, excise taxes, [MEMBER ONE] will cause the Taxpayer's Articles of Organization to be filed with the [STATE-NOT TENNESSEE] Secretary of State's Office. An Application for a Certificate of Authority for the Taxpayer to do business in Tennessee will then be filed with the Tennessee Secretary of State accompanied by the Taxpayer's [STATE-NOT TENNESSEE] Certificate of Existence, or equivalent, and the Taxpayer's Articles of Organization.

If the Tennessee Department of Revenue cannot issue a favorable ruling to the effect that neither the Taxpayer nor [MEMBER ONE] are subject to Tennessee franchise, excise tax, then

[COMPANY A and COMPANY B] will be substituted as the Taxpayer's members along with [MEMBER TWO].

QUESTIONS PRESENTED

1. Will the Taxpayer be exempt from Tennessee franchise, excise taxes pursuant to the provisions of Tenn. Code Ann. § 67-4-2008(a)(8)?
2. Will [MEMBER ONE], [MEMBER TWO], [COMPANY A and COMPANY B] be subject to Tennessee franchise, excise tax?
3. If [COMPANY A and COMPANY B] are substituted for [MEMBER ONE] as the Taxpayer's owners/members, what tax consequences will result?

RULINGS

1. Yes.
2. [MEMBER ONE] and [MEMBER TWO] will be subject to Tennessee franchise, excise tax. [COMPANY A and COMPANY B] will not be subject to Tennessee franchise, excise tax on any of the operations of the Taxpayer since such operations will be taxed to the Taxpayer's 1st tier owners, [MEMBER ONE] and [MEMBER TWO]. [COMPANY A and COMPANY B] will be subject to Tennessee franchise, excise tax only if they have untaxed net worth, real or tangible personal property or net earnings attributable to Tennessee and unrelated to and outside the scope of the activities that gave them their not-for-profit status.
3. Provided that [COMPANY A and COMPANY B] and [MEMBER TWO] agree, in compliance with the applicable statutes, to be fully liable for its debts, obligations and liabilities to the same extent as a general partner in a general partnership, the Taxpayer will be exempt from Tennessee franchise, excise taxes. [COMPANY A and COMPANY B] and [MEMBER TWO] will be subject to Tennessee franchise tax on the greater of their respective ownership shares of the Taxpayer's net worth or book value of real and tangible personal property owned or used in Tennessee and Tennessee excise tax on their respective ownership shares of the Taxpayer's net earnings or net loss.

[MEMBER ONE] would have no Tennessee franchise, excise tax liability unless it has physical presence in Tennessee or Tennessee operations other than solicitation of sales of tangible personal property in interstate commerce that are protected by Title 15, U.S.C.A. §§ 381-384.

ANALYSIS

The Taxpayer Will Be Exempt From Franchise, Excise Tax

Tenn. Code Ann. § 67-4-2008 (a)(8) makes the following provisions:

(a) There shall be exempt from the payment of the excise tax levied under this part the following:

* * * * *

(8) Limited Liability Companies, limited partnerships and limited liability partnerships, all of whose members or partners are fully liable for the debts, obligations and liabilities of the entity, as provided in subsections (b), (c) and (d), and who have filed appropriate documentation to that effect with the secretary of state on or before the first day of the taxable year; provided, for tax years beginning before January 2, 2000, such documentation shall be filed on or before September 15, 2000; and further provided, that this item (8) shall not apply to any limited liability company, limited partnership or limited liability partnership which is owned, in whole or in part, directly or indirectly, by a corporation other than a not-for-profit corporation. If an additional partner or member is admitted to the entity, such partner or member must file the appropriate documentation with the secretary of state within sixty (60) days of such person's admission. For purposes of this subdivision, partners or members may be "fully liable" even though one (1) or more persons or individuals dealing with the partnership or limited liability company have by contract agreed to limit their claims against one (1) or more partners or members or against the partnership or limited liability company.

Tenn. Code Ann. § and 67-4-2008(d) makes the following provisions whereby a limited liability company may qualify for the exemption:

(d) (1) Notwithstanding any provision of law to the contrary, the articles of a limited liability company may provide that one (1) or more specifically identified members, as named in the articles, will be personally liable for all of the debts, obligations and liabilities of the limited liability company and, if so, each such specifically identified member shall be liable to the same extent as a general partner in a general partnership; provided, that:

(A) In order to be effective, each member so identified must sign the articles, or an amendment to the articles containing this provision. The amendment or articles may provide that it is only effective if all members make and maintain such an election. In such case the articles must affirmatively identify each member and state that such persons constitute all of the members of the limited liability company;

(B) Each such member shall continue to be personally liable for all of the debts, obligations and liabilities of the limited liability company to the same extent as a general partner of a general partnership until:

(i) The member withdraws from the limited liability company; or

(ii) The articles are amended to strike such member's name as a member electing joint and several liability or, if the articles provide that all members must elect joint and several personal liability for all of the debts, obligations and liabilities of the limited liability company if any are to be so liable, an amendment striking one (1) member who continues to be a member shall strike all members. Such document must be executed by the member desiring to cease being so liable and promptly delivered to any remaining members who are identified in the articles as personally being jointly and severally liable for the debts, obligations and liabilities of the limited liability company.

Tenn. Code Ann. § 67-4-2105(a) adopts the above exemption for franchise tax purposes by making a franchise tax liability exception for “. . . those . . . otherwise exempt under § 67-4-2008 . . .”

The above statutes make it clear that a limited liability company will be exempt from Tennessee franchise, excise tax if all of the following criteria are met:

1. All of its members must agree to be fully liable for its debts, obligations and liabilities to the same extent as a general partner in a general partnership.
2. Before the first day of the taxable year, the appropriate documentation must be filed with the Secretary of State identifying each member, stating that those members identified constitute all of the members of the limited liability company, and stating that each specifically identified member shall be liable to the same extent as a general partner in a general partnership for its debts, obligations and liabilities.
3. The limited liability company is not owned in whole or in part, directly or indirectly, by a corporation other than a nonprofit corporation.

The first criterion above will be met by the statement in the Taxpayer's proposed Articles of Organization which [MEMBER ONE] and [MEMBER TWO] will sign. The second criterion will be met when the Taxpayer's Articles of Organization are filed with

the [STATE-NOT TENNESSEE] Secretary of State and an Application for Certificate of Authority, accompanied by a copy of such Articles and a Certificate of Existence, or equivalent, from the State of [STATE-NOT TENNESSEE] are filed with the Tennessee Secretary of State. The third criterion will be met because the only corporations that, directly or indirectly, will have an ownership interest in the Taxpayer are not-for-profit corporations.

If additional parties become members of the limited liability company, the appropriate documentation showing that the new member(s) will be liable to the same extent as a general partner in a general partnership for its debts, obligations and liabilities will need to be filed with the Tennessee Secretary of State within 60 days in order for the exemption to continue. The exemption will no longer be available if a member ceases to be personally liable for the debts, obligations and liabilities of the Taxpayer to the same extent as a general partner in a general partnership or if a corporation, other than a not-for-profit corporation, directly or indirectly acquires an ownership interest in the Taxpayer.

[MEMBER ONE] and [MEMBER TWO] Will Be Subject To Franchise, Excise Tax

Tenn. Code Ann. § 67-4-2004(9), set forth in pertinent part below, defines a “general partnership” as follows:

“General partnership” means a partnership in which all partners, as defined by state law, are fully liable for the debts of, or the claims against, the partnership.

General partnerships are not subject to Tennessee franchise, excise tax because they are not among the business entities defined as a “person” or “taxpayer” by Tenn. Code Ann. § 67-4-2004(20).

The primary and essential element of a general partnership is that its owners/partners are fully liable for its debts. Because each of the Taxpayer’s members will affirmatively agree to be personally liable for its debts, the Taxpayer will have become tantamount to a general partnership for Tennessee franchise, excise tax purposes.

Eighty percent of the Taxpayer’s operations in Tennessee will accrue to [MEMBER ONE] as an 80% owner of the Taxpayer and [MEMBER ONE] will be subject to Tennessee franchise, excise tax. [MEMBER ONE] must include its 80% ownership share of the Taxpayer’s net earnings or net loss in the computation of its excise tax base. Likewise, [MEMBER ONE] must include its 80% ownership share of the Taxpayer’s net worth in the computation of its franchise tax base and 80% of the Taxpayer’s real and tangible personal property owned or used in Tennessee must be included in [MEMBER ONE] franchise tax minimum measure.

Pursuant to Tenn. Code Ann. §§ 67-4-2012(b), (e) and (g) and 67-4-2111(b)(2), (e)(3) and (g)(2), [MEMBER ONE] will include its ownership share of the Taxpayer’s property, payroll and receipts in its apportionment formula for franchise, excise tax purposes in

addition to its own property, payroll and receipts. [MEMBER ONE] will also include its ownership share of the Taxpayer's real and tangible personal property owned or used in Tennessee in its franchise tax minimum measure in accordance with Tenn. Code Ann. § 67-4-2108(a)(3).

As a Tennessee not-for-profit corporation, [MEMBER TWO] is subject to Tennessee excise tax only on its Tennessee net earnings to the extent that such earnings constitute unrelated business taxable income as defined in § 512 of the Internal Revenue Code or are otherwise subject to income tax under Subtitle A of such code. It will also be subject to excise tax on all of its Tennessee net earnings that are attributable to any activities unrelated to and outside the scope of the activities that gave it its nonprofit status. See Tenn. Code Ann. § 67-4-2007(a) and 67-2105(a).

Accordingly, [MEMBER TWO] must include its 20% ownership share of the Taxpayer's net earnings or net loss in the computation of its excise tax base. [MEMBER TWO] will also be subject to franchise tax and must include its 20% ownership share of the Taxpayer's net worth in the computation of its franchise tax base and 20% of the Taxpayer's real and tangible personal property owned or used in Tennessee must be included in its franchise tax minimum measure.

The taxation of [MEMBER ONE] and [MEMBER TWO] prevents them and other similarly situated business entities from escaping franchise, excise tax liability on certain business operations by putting such business operations in an otherwise taxable Tennessee limited liability company, limited partnership or limited liability partnership that is tax exempt because its members or partners have agreed to be fully liable for its debts.

[COMPANY A and COMPANY B] will not be subject to Tennessee franchise, excise tax on any of the operations of the Taxpayer since such operations will be taxed to the Taxpayer's 1st tier owners, [MEMBER ONE] and [MEMBER TWO]. [COMPANY A and COMPANY B] will be subject to Tennessee franchise, excise tax only if they have untaxed net worth, real or tangible personal property or net earnings attributable to Tennessee and unrelated to and outside the scope of the activities that gave them their not-for-profit status,

If [COMPANY A and COMPANY B] are substituted for [MEMBER ONE] as
Owners/Members of the Taxpayer
Along With [MEMBER TWO], all Three Will be Subject to Tennessee Franchise, Excise
Tax
And the Taxpayer Will Be Exempt

An alternative plan presented in the facts is for [COMPANY A and COMPANY B] to be substituted for [MEMBER ONE] as owners/members of the Taxpayer. In this factual situation, [COMPANY A and COMPANY B] and [MEMBER TWO] would be owners/members of the Taxpayer.

In such a situation, the Taxpayer would be exempt from Tennessee franchise, excise tax provided that [COMPANY A and COMPANY B] and [MEMBER TWO] agree, in compliance with the applicable statutes referenced and explained above, to be fully liable for its debts, obligations and liabilities to the same extent as a general partner in a general partnership.

[COMPANY A and COMPANY B] and [MEMBER TWO] will be subject to Tennessee franchise tax on the greater of their respective ownership shares of the Taxpayer's net worth or the book value of its real and tangible personal property owned or used in Tennessee. They would be subject to Tennessee excise tax on their respective ownership shares of the Taxpayer's net earnings or net loss.

[MEMBER ONE] would have no Tennessee franchise, excise tax liability unless it has an ownership interest in a general partnership, or its substantial equivalent, physical presence in Tennessee or Tennessee operations other than the solicitation of sales of tangible personal property in interstate commerce which are protected from state taxation by Title 15, U.S.C.A. § 381-384, better known as Public Law 86-272.

Arnold B. Clapp
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APPROVED: Loren L. Chumley, Commissioner

DATE: 9/15/04